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In The

Supreme Court of the United States

October Term 1995

COST CONTROL MARKETING & SALES MANAGEMENT OF VIRGINIA, INC.; WILLIAM P. PETERSON; ARTHUR KUJAWSKI; RICHARD R. COSTENBADER; JAMES M. MARLEY,

Petitioners,

v.

U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT,

Respondent.

Petition for Writ of Certiorari

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FOURTH CIRCUIT

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HIP

I. STATEMENT OF QUESTIONS PRESENTED

1. Shall the word "developer" as used in the Interstate Land Sales Full Disclosure Act be construed to encompass anyone who buys or sells lots in an eight year old completed subdivision?

2. Is an award of civil restitution exempt from discharge pursuant to 11 U.S.C. § 523(a)(7)?

3. In a civil action, may an individual be held liable without evidence?

4. In an administrative enforcement action, may the ultimate burden of proof as to damages be shifted to the defendants after an initial proffer of hearsay by the Government?

5. May an individual be ordered to disgorge moneys he never received?

II. PARTIES

The parties to this petition are Cost Control Marketing and Sales Management of Virginia Incorporated (CCMV), William P. Peterson, Arthur Kujawski, Richard R. Costenbader and James M. Marley.

The parties in the Courts below were, in addition to those parties named above, Thornton Byron, Stuart Guskind, Earl Hissom, Monticello Development Corporation (MDC) and the United States Department of Housing and Urban Development, (HUD).

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V. PRIOR OPINIONS

The prior opinions issued by the Courts below in the instant proceeding have all been published and are cited as follows: Kemp v. Peterson, 940 F.2d 110 (4th Cir. 1991), Kemp v. Cost Control Marketing & Sales Mgm't, 790 F. Supp. 1274 (W.D. Va. 1992), Cisneros v. Cost Control Marketing & Sales Mgm't, 862 F. Supp. 1531 (W.D. Va. 1994), United States Dep't of Housing and Urban Development v. Cost Control Marketing & Sales Mgm't, 64 F.3d 920 (4th Cir. 1995).

VI. JURISDICTION

Petitioners seek this Court's review of the judgment entered on September 8, 1995 by the United States Court of Appeals for the Fourth Circuit, to which a petition for rehearing and suggestion for rehearing en banc were denied by that Court's order of November 3, 1995, by a Petition for Writ of Certiorari pursuant to the jurisdiction conferred by 28 U.S.C. § 1254(1). This Petition is timely filed because it was mailed within ninety days of November 3, 1995, the date of the denial of the petition for rehearing. Rules 13.4 and 29.2.

VII. STATUTES INVOLVED

11 U.S.C. § 523:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt --

. . .

> (7) to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss, other than a tax penalty --

. . .

15 U.S.C. § 1701:

For purposes of this title, the term --

. . .

> (5) "developer" means any person who, directly or indirectly, sells or leases, or offers to sell or lease, or advertises for sale or lease any lots in a subdivision;

. . .

VIII. STATEMENT OF THE CASE

Procedural History

This action was commenced by the filing of a Complaint on November 15, 1989, by the plaintiff, the U.S. Department of Housing and Urban Development ("HUD"). (A81-A97) The Complaint named as defendants Cost Control Marketing and Sales Management of Virginia, Inc. ("CCMV"), and William P. Peterson, Arthur Kujawski, Richard R. Costenbader and James M. Marley (collectively hereinafter, the "Individual Defendants"), the Petitioners herein. (A81) Also named in the Complaint were Thornton Byron, Stuart Guskind, Earl Hissom and Monticello Development

Corporation, ("MDC"). (A81) Served with the Complaint was a Motion for a Preliminary Injunction. (A93) A Preliminary Injunction was entered by the District Court on February 14, 1990. (A16)

On February 20, 1990, CCMV filed a Motion for Summary Judgment, and on February 21, 1990, CCMV filed a Motion to Strike Count III of the Complaint. On March 9, 1990, HUD filed a Motion for Partial Summary Judgment on Counts I and II of the Complaint.

On March 16, 1990, the Individual Defendants noted an appeal to the U.S. Court of Appeals for the Fourth Circuit from the Preliminary Injunction.

On May 18, 1990, the District Court entered an order denying CCMV's Motion for Summary Judgment and Motion to Strike, and granting HUD's Motion for Partial Summary Judgment.

On May 21, 1991, HUD filed a Motion for Summary Judgment on Count III of the Complaint and For Entry of Judgment on all Counts against the Individual Defendants.

On August 2, 1991, the Fourth Circuit issued its opinion regarding the Individual Defendant's appeal of the Preliminary Injunction, and remanded the case for factual findings to support the asset freeze. Kemp v. Peterson, 940 F.2d 110 (4th Cir. 1991). (A22-A30) On November 11, 1991, the District Court held a hearing pursuant to the Fourth Circuit's order of remand.

On April 22, 1992, the District Court entered the Interim Judgment Order, which granted HUD's Motion for Summary Judgment on Count III of the Complaint, and ordered interim relief as to all counts. (A31-A45) On May 11, 1992, the Individual Defendants

noted their appeal of the Interim Judgment Order to the Fourth Circuit. On June 22, 1992, the Fourth Circuit dismissed the appeal without prejudice to the filing of a subsequent appeal once all matters had been made final.

On July 20, 1992, defendants Marley[1], Peterson[2] and Costenbader[3] filed for bankruptcy protection in the U.S. Bankruptcy Court for the Middle District of Pennsylvania. Inclusive in each filing was the District Court's April 22, 1992 judgment. On January 7, 1993, defendant Marley received a discharge in bankruptcy. The stay created by these bankruptcy filings was never filed by HUD even though HUD was ordered by the court to do so. (A51-A52) Defendants Costenbader and Peterson were discharged in bankruptcy on January 15, 1993. The Marley and Peterson cases were never closed, and are still open. Defendant Costenbader's case was reopened on motion of the debtor on January 28, 1994.

On January 7, 1994, HUD filed a Motion for Final Judgment and for Sanctions. On July 27, 1994, Magistrate Crigler filed his Report and Recommendation concerning final judgment. (A53-A61) On August 8 and August 12, 1994, CCMV and the Individual Defendants, respectively, filed their Objections to the Magistrate's Report. On September 15, 1994, the District Court entered an order overruling the defendants' Objections to the Magistrate's Report and entering final judgment. (A73-A76)

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[1] Case No. 5-92-01299
[2] Case No. 5-92-01300
[3] Case No. 5-92-01301

Factual Summary

During the entire five-year span of this litigation, not one witness ever took the stand, and not one piece of evidence was ever introduced in open court. Instead of relying upon admissible evidence, HUD filed declarations and affidavits. (A81) Due to the nonexistence of evidence in this matter, it is impossible to give citations to the record for the summary given below. The following facts, offered to the District Court below in a memorandum, are substantially uncontroverted.

In 1968, defendant Monticello Development Corporation ("MDC"), purchased land surrounding Lake Monticello in Fluvanna County, Virginia. MDC developed the land into a subdivision (known as Lake Monticello Subdivision, hereinafter the "Subdivision"), consisting of 4,592 lots, and by 1978 had sold 4,540, or 99%, of those lots. (A3) During its sales effort, MDC had fully complied with the registration and other requirements of the Interstate Land Sales Full Disclosure Act, 15 U.S.C. § 1701, et seq., (the "ILSFDA"). By year end 1978, MDC had fully constructed the Subdivision and had improved it with roads, utilities, club house, marina, lakes, picnic areas, tennis courts and other amenities.

Defendant Cost Control Marketing and Sales Management of Virginia, Inc. ("CCMV") was organized as a Virginia corporation in 1986. At all times relevant herein, defendants Peterson, Kujawski, Marley and Costenbader (collectively, the "Individual Defendants"), were, respectively, the president, vice president,

secretary/treasurer and Chief Executive Officer of CCMV.

CCMV was organized for the sole purpose of acquiring Lake Monticello lots from the general public, placing them into inventory, and re-selling the lots to new buyers. In all, CCMV purchased 919 vacant lots at the 4592 lot Subdivision from August 1986 to July 1989. (A3) CCMV made no improvements to its lots. Between May 1987 and December 1989, CCMV sold 585 lots from its inventory. In no instance did CCMV undertake to do any other activity within the Subdivision other than to inventory its 919 lots and thereafter market and sell them.

CCMV admitted it made no effort to comply with ILSFDA. Rather, it is CCMV's position that MDC and not itself is Lake Monticello's sole developer, and accordingly, compliance with ILSFDA by neither CCMV nor any other lot owner in the Subdivision was not required.

There is no evidence in the record to indicate that the Individual Defendants ever themselves engaged in the sale of lots in the Subdivision. The record establishes that the Individual Defendants were officers of CCMV, and nothing more. There is no evidence that any of the Individual Defendants ever received so much as one cent from the proceeds of CCMV's sales of lots in the Subdivision. There is no evidence in the record that any of the Individual Defendants engaged in any acts tantamount to "aiding and abetting" CCMV in any allegedly illegal activity. There is no evidence in the record which serves as a factual predicate for the liability of the Individual Defendants upon any theory. Other than establishing the

Individual Defendants' status as officers of CCMV, the record is completely silent as to any of their alleged acts or omissions.

The District Court ruled CCMV to be a developer within the ILSFDA and liable therefore and also held the Individual Defendants jointly and severally liable for $8.6 million, which the District Court adjudicated as nondischargeable in bankruptcy. (A73) No trial was ever had. During the entire five year span of this litigation, not one witness ever took the stand. Not one exhibit was ever introduced into evidence in open court. No Individual Defendant ever appeared in person before the Trial Judge. All matters were adjudicated upon motion for summary judgment, with grossly inadequate evidentiary support.

The Fourth Circuit affirmed the District Court's ruling in all respects. (A1)

IX. ARGUMENT

A. The Petitioner CCMV was not a "Developer" within the meaning of the Interstate Land Sales Full Disclosure Act.

The Interstate Land Sales Full Disclosure ("ILSFDA") was not designed to regulate the on-going resale of lots within a subdivision completed almost eight years earlier. The legislative history of the ILSFDA makes clear that the ILSFDA was designed to regulate the original developers who sell lots in an incomplete subdivision.

The ILSFDA was passed by Congress as Title XIV of the Housing and Urban Development Act of 1968 and became effective

on April 28, 1969. It imposed a comprehensive federal regulatory framework upon the real estate development industry. The Act was passed to prevent "false and deceptive practices in the sale of **unimproved** tracts of land by requiring developers to disclose information needed by potential buyers." Anders v. Dakota Land and Development Co., Inc., 380 N.W.2d 862, 865 (Minn. App. 1986) (emphasis added); Flint Ridge Development co. v. Scenic Rivers Association of Oklahoma, 426 U.S. 776, 778, 96 S.Ct. 2430, 2433, 49 L.Ed.2d 205(1976). The situation that the ILSFDA is designed to prevent is aptly described in McCown v. Heidler, 527 F.2d 204 (10th Cir. 1975):

> The 'developer' of a land sale plan is usually a corporate entity which, in a fraudulent scheme . . ., ends up defunct and offers no reserve for recovery to those persons defrauded; so, too, the end selling agent, when the development collapses financially, is often long gone or cannot respond pecuniarily.

The legislative intent in passing the ILSFDA was to advise potential buyers, in writing, what the developer promises for a subdivision upon its completion. The ILSFDA's remedial measures afford purchasers recourse should the developer fail to complete the development as represented at the time of purchase.

Obviously, the ILSFDA has a prospective view; the potential buyer does not need disclosure of the features of a completed

development, for the subdivision in place speaks for itself. The ILSFDA's focus was to advise the potential buyer of what the developer promised in an incomplete subdivision.

Since the adoption of ILSFDA, several circuits have interpreted "developer" to include and exclude certain entities depending upon the circumstances at hand. Unlike the District and Circuit Courts in the instant case, these cases have disregarded the strict interpretation of "developer" by considering the circumstances of the case. The District Court's ruling, with the Fourth Circuit affirming, has resulted in a split among the Circuits holding different views on the issue. Only the Fourth Circuit appears to follow the narrow interpretation of "developer" in holding CCMV subject to the ILSFDA because it sold a lot in Lake Monticello without regard to any extenuating circumstances such as from whom title was obtained, the number of lots involved, the method of sale, and participation by the owner in activities within the subdivision. The Fourth Circuit represents the minority view.

The Tenth Circuit applied an opposite interpretation to "developer" by considering extenuating factors and circumstances. This is the majority view. In McCown v. Heidler, 527 F.2d 204 (10th Cir. 1975), the meaning of developer was expanded to include aiders and abetters and controlling stockholders and directors who were behind the corporate bankrupt subdivider. The Third Circuit by inference followed McCown in Bartholomew v. Northampton Nat. Bank of Easton, 584 F.2d 1288 (3rd Cir. 1978) holding that in the

absence of any allegation either that banks involved in the financing or that the sole equitable owner sold, offered to sell or advertised for sale any lots in the subdivision or that they performed any such activities through agents or other means were not developers within the meaning of ILSFDA. See also, Adema v. Great Northern Development Co., 374 F. Supp. 318 (N.D. GA. 1973) where a lender by holding a security interest in lots within a subdivision was held not to be a developer.

The Sixth Circuit in 1980 was presented with circumstances substantially similar to the case at bar, holding differently than the Fourth Circuit in its instant ruling. In Cumberland Capital Corp. v. Harris, 621 F.2d 246 (6th Cir. 1980), HUD contended Cumberland was a "developer" within the meaning and intent of ILSFDA. Cumberland argued otherwise.

Cumberland's involvement in land sales was an outgrowth of its activities as a lending institution. As security on loans, it took mortgages or deeds of trust on unimproved lots in a subdivision. On the default of a borrower, Cumberland would foreclose on the lot. At foreclosure, Cumberland would sometimes purchase the lot and thereafter offer it for resale.

It is in the **resale** of the lot by Cumberland that HUD took the position Cumberland was a developer and thus fell within the mandates of ILSFDA. The Appellate Court noted that Cumberland fell within the strict definition of the term "developer". Id. at 250. However, it found that for Cumberland to take title to a lot in subdivision from a person who was a lot

purchaser himself (and not the original developer), hold such lot for a period of time and thereafter advertise and sell such lot was not a develooper within the intents and purposes of the ILSFDA. In effect, the Court stated that to buy and resell a lot, and do no more, is insufficient to make it a developer.

The 1980 Cumberland case hinges on the concept of participation. The fact that Cumberland had taken title by deed in lieu of foreclosure or by foreclosure itself was immaterial; in effect acquisition of title is irrelevant. What is important is what does not occur after acquisition of title. Cumberland states that if the lot owner participates in the development of the subdivision, it is a developer and the ILSFDA applies; if no such participation occurs, then ILSFDA does not apply.

Significant also was the lack of any concern as to the number of lots involved. It was immaterial to the Sixth Circuit whether Cumberland owned one or more lots or how it acquired title. The ILSFDA will apply when a person sells "any lots" in a subdivision, be it one or more. Quantity, therefore, is not in issue in resolving who is and who is not a developer under the ILSFDA.

The Fourth Circuit also disregarded numerous state court decisions that had followed the McCown and Cumberland concepts which applied the definition of "developer" to different fact situations, mainly under condominium law. In McKnight v. Board of Directors, 512 N.E.2d 316 (Ohio 1987), the Ohio Supreme Court examined the definition of "developer" under the Ohio Condominium

Statute.[4] By applying the same ruling of Cumberland, the court held a mortgagee in acquiring title to a condominium and re-selling it does not of itself make the mortgagee a developer. However, becoming intertwined with the promotion and development of the complex and participating in and proffiting from the business results in the mortgagee becoming a developer. See also, Chotka v. Fidelco Growth Investors, 383 So.2 1169 (Fla. App. 1980) and First Federal Savings and Loan v. Department of Business Regulations, 472 So.2d 494 (Fla. App. 5 Dist. 1985).

CCMV in acquiring its 919 lots in the 4592 lot Subdivision had the Cumberland decision before it to act as a guide. Precedent having been established, CCMV in good faith believed itself not to be a developer because it simply acquired lots in a completed eight year old Subdivision, and marketed and resold them to the general public. During the holding period, CCMV took no participation in the Subdivision and performed absolutely nothing to any lot it owned. It followed the mandate and spirit of Cumberland exactly and was correct in concluding itself not to be a developer within the meaning of the ILSFDA.

For the Disrict Court and the Fourth Circuit to disregard the spirit and legislative intent of ILSFDA and to abrogate the line of cases in other Districts (as well as state court decisions) to the contrary results in the slimiest of minorities and a split which this Court must resolve. The

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[4] It should be noted that the definition of developer under the Ohio Condominium Statute parallels the definition of developer under the ILSFDA.

decision also represents a gross injustice in imposing joint and several liability of over eight million dollars on four individuals.

Statistics maintained by OILSR indicate that as of January 2, 1992, there had been 12,705 filings with HUD covering 6,579 subdivisions since the inception in April, 1969 of ILSFDA. There were 3,252 active registrations covering 2,056 subdivisions; 262 applicaitons were in process; and 9,453 filings had been suspended. The 6,579 subdivisions cover 6,121,410 lots with a total acreage of 5,490,012.

> In affirming the District Court, the Fourth Circuit has stated that if any one person sells or leases or offers to sell or leases or advertises for sale or lease any of these 6,121,410 lots that is not ocherwise exempted within these 6579 subdivisions, registration with HUD is mandatory giving rise to the need of a (I) Statement of Record (ii) mandatory language inclusion in the contract, and (iii) a right of recision notwithstanding that:
>
> - the seller is anyone other than the original developer;
> - the seller did no more than purchase a lot and attempted to re resell it;
> - the seller did not participate in any aspect of the subdivision's creation, construction, or sell-out;
> - the seller acquired one lot or multiple lots; or

- the seller acquired the lot by gift, devise, arms-length purchase, or otherwise.

This conclusion thwarts economic growth, frustrates the economy, and directly involves government in the affairs of buyer and seller of a lot in an otherwise completed subdivision. The District Court's ruling and the Fourth Circuit's affirmation disregard the essential grasp of the ILSFDA and has created a situation that prevents banks from lending on lots in a subdivision, enables current buyers to avoid a lot purchase where the predecessor in title failed to register with OILSR and has effectively placed the industry in a state of total paralysis.

B. Orders of civil restitution are not exempt from discharge pursuant to 11 U.S.C. § 523(a)(7).

In its Final Order of September 15, 1994, the District Court ordered each of the Individual Defendants, jointly and severally, to pay to HUD civil restitution amounting to $8,648,048.00, plus interest at the Treasury rate until paid. (A73-A76) In the accompanying Memorandum Opinion, the District Court ruled that this amount was exempt from bankruptcy discharge pursuant to 11 U.S.C. § 523(a)(7).(A66-A68) These rulings were affirmed by the Court of Appeals. These opinions are in direct conflict with the opinion of another jurisdiction on the same issue, In re Taite, 76 B.R. 764 (Bankr. C.D. Cal. 1987). The conflict arises out of a failure by the Fourth Circuit to interpret appropriately the scope of this Court's

ruling in Kelly v. Robinson, 479 U.S. 36 (1986), wherein this Court decided that orders of criminal restitution are automatically nondischargeable in bankruptcy.

This Court should grant certiorari in this case to resolve the emerging conflict of opinion and give needed guidance to the lower federal courts on the appropriate interpretation of this Court's prior holding in Kelly v. Robinson, as applied in civil cases.

In Kelly v. Robinson, 479 U.S. 36 (1986), this Court confronted the issue of whether criminal restitution orders were exempt from discharge pursuant to 11 U.S.C. § 523(a)(7). Even though the term "restitution" and the remedial doctrines it encompasses are not normally thought of in the same context as fines, penalties and forfeitures, the Court concluded that criminal restitution orders ought to be exempted under § 523(a)(7). The Court reasoned that even though one aspect of criminal restitution orders is to make the victim whole, the overriding interest at stake is to serve the punitive goals of the criminal justice system. Id. at 53. The Court was extremely wary of permitting the Bankruptcy Code to interfere with criminal sanctions, particularly against a historical background in which criminal orders had been immune from the bankruptcy process. Id. at 44-47.

None of these concerns come into play when the restitution order at issue results from a purely civil proceeding. In this case, the District Court ordered the Individual Defendants to pay restitution in an amount precisely equal to the court's

purported estimate of the value of the wrongdoing. It has been HUD's position throughout this litigation that the funds recovered would be held in trust for and disbursed to the lot purchasers. (A35) There can be no question that the overriding goal of the restitution at issue in this case is compensatory, and not punitive.

Even if civil restitution orders produce a deterrent effect upon the wrongdoer as a by-product, this does not change their essential nature as mechanisms by which victims are made whole. Deterrence and compensation go hand in hand in the civil law. But deterrence is not punishment. The goal of deterrence is advanced by compensatory remedies as well as punitive damages. Simply because the compensatory remedy causes a deterrent effect does not render that remedy punitive. Both compensatory and punitive remedies are designed to have deterrent effects. Accordingly, the presence of a deterrent effect or purpose in any given remedy does not indicate that the remedy is punitive.

Indeed, courts discussing the disgorgement remedy in the securities context have explicitly held that it is remedial in nature and not penal. S.E.C. v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir. 1971), cert. denied, 404 U.S. 1005 (1971), S.E.C. v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1104 (2d Cir. 1972). If the disgorgement ordered is sufficiently oppressive such that it constitutes a penalty, then it is unlawful. Id. This leads one to the inescapable conclusion that if the disgorgement ordered by the District Court below is a penalty, then it is unlawful

and must be dissolved. If, on the other hand, the relief ordered is remedial, then it is dischargeable. Either way, the District Court and Court of Appeals erred and must be reversed.

Punitive remedies are distinguished from compensatory remedies by the moral reprobation inherent in the former. Whereas the purposes of compensatory remedies are compensation and deterrence, the purposes of punitive remedies are retribution and deterrence. It is this sense of moral outrage, the retributive purpose, which distinguishes penal sanctions from compensatory remedies. The lack of a penal purpose to the order of civil restitution places it outside the realm of "fines, penalties and forfeitures."

The plain language of the statute compels this conclusion. The money judgment at issue is not a fine. Fines are not computed by reference to damage or loss, and then paid over to the victim. Restitution is. The judgment is not a penalty, for all the same reasons discussed above; its purpose is not punitive. Nor is it a forfeiture. Black's defines "forfeiture" as "something to which the right is lost by the commission of a crime or fault or the losing of something by way of penalty." This last term is also restricted to the domain of criminal or punitive sanctions. United States v. Bonanno Crime Family, 683 F. Supp. 1411, 1449 (E.D.N.Y. 1988)(disgorgement of lawful profits is impermissible forfeiture). Civil restitution obligations do not fall within the ambit of any of these three terms. Singularily and when read together, they

refer only to sanctions whose objective is overridingly penal in nature.

To date, there is only one court which has squarely addressed the question of dischargeability presented in this petition. It is factually on all fours with the case at bar, and analyzes and decides this very issue. The case is In re Taite, 76 B.R. 764 (Bankr. C.D. Cal. 1987), and was ignored by the Court of Appeals below.

The debtors in Taite were the principals of a defunct retail carpet business. Id. at 765-66. The corporation had been the subject of an investigation by the state Attorney General's office, which found evidence of widespread fraudulent activity. Id. A civil enforcement action was brought by the State of California against the individual debtors, which, after a three month trial, resulted in the imposition of civil penalties totaling $750,000.00 and an order of restitution in the amount of $256,645.00. Id. at 766, 768. The civil penalty was ordered pursuant to a statute which permitted the assessment of up to a $2,500 penalty for each violation. The restitution was calculated by receiving evidence of the aggregate losses of a pool of 3,001 defrauded customers. Id. at 768. The judgment was made payable to the state of California, but was to be used to reimburse former customers for funds paid to the debtors in fraudulent transactions. The debtors attempted to bankrupt both sums.

The court had little difficulty in concluding that the $750,000 civil penalty was nondischargeable pursuant to § 523(a)(7). The court analyzed the statute pursuant to which the penalties had been ordered, and cases interpreting the statute, and discerned

that the primary purpose of the civil penalties provision of the state Business and Professions Code was penal. Id. at 769. Sums awarded pursuant to that section were intended by the legislature to be punitive, rather than compensatory. Accordingly, the civil penalty was exempt from discharge. Id.

The opposite results with respect to the restitution award. The court acknowledged Kelly v. Robinson, but recognized that the reasoning and holding of that opinion was limited to criminal judgments. Id. In contrast, civil actions carry a lower standard of proof, and rarely require findings of criminal, wrongful intent as a prerequisite to liability. Even though the disgorgement of unlawful profits serve both compensatory and deterrent objectives, restitution/disgorgement awards are primarily intended to make whole the victims. Id. at 772.

Furthermore, the character of the party bringing the action ought not determine the dischargeability of the relief. Id. at 773. Had the individual customers brought action against the debtor seeking restitution for fraud, the judgment would not be automatically dischargeable as a fine owing to a governmental unit under § 523(a)(7). Rather, the customers would have to bring an adversary proceeding pursuant to § 523(c) to determine dischargeability under § 523(a)(2), the exemption from discharge for judgments predicated upon fraud. Id. The state ought not be able to deprive the debtors of their right to a hearing pursuant to § 523(c) simply by bringing the restitution action in the name of the state, rather than in the name of the customers, who are the true

beneficiaries of the recovery in either case. To hold otherwise would frustrate the overall bankruptcy goal of classifying claims, rather than creditors. Id.

All those compelling interests at stake in Robinson involving non-interference in the criminal sentencing process are absent in cases where only a civil money judgment is at stake. The bankruptcy court held the restitution award was not automatically immune from discharge pursuant to § 523(a)(7).

The single significant factual difference between Taite and the case at bar is that in Taite, the government agency plaintiff had brought a timely adversary proceeding in the bankruptcy court pursuant to § 523(c) to challenge dischargeability pursuant to the fraud exception of § 523(a)(2). Given the overwhelming evidence of fraud introduced at the debtors' three-month trial, the court had little difficulty in concluding that § 523(a)(2) exempted the judgment from discharge. By contrast, in the case at bar, HUD filed pleadings in the Bankruptcy Court for the Middle District of Pennsylvania, where the Defendants' bankruptcies were pending, requesting three extensions of time to file a dischargeability complaint. The bankruptcy court granted these requests, but HUD never followed through and brought the action. The Individual Defendants were subsequently discharged without adjudicating the issue.

Like the statute at issue in Taite, the ILSFDA also has a section which provides for civil penalties. 15 U.S.C. § 1717a permits the imposition of penalties in the amount of $1,000 per violation, if the defendant

knowingly violated the statute in a material way. This section may properly be characterized as penal, due to the burden of proving knowing intent and materiality. Furthermore, damages awarded pursuant to this section are computed per violation, without resort to any kind of actual damage calculation. Penalties awarded pursuant to this section would likely fall within the automatic exception of § 523(a)(7). By contrast, in the case at bar, HUD has requested relief pursuant to the general equity powers of the court, pursuant to 15 U.S.C. § 1719. Accordingly, the relief awarded by the District Court is no more than a regular civil money judgment. If HUD had wished to have its judgment exempt from discharge, it should have followed through with its previously expressed intentions and filed the requisite complaints in the bankruptcy court.

Congress intended to provide for penal sanctions for willful violations of the ILSFDA. It did so by enacting sections 1717 and 1717a of title 15. The former is a criminal statute authorizing incarceration. The latter is a civil statute which calculates penalties per violation, without regard to the quantum of the wrongdoing. The relief in this case was awarded pursuant to the general equitable grant of authority contained in § 1719. It is a compensatory money judgment, not a penal sanction. Penal sanctions may properly be classified as fines, penalties or forfeitures. Compensatory remedies may not. The judgment awarded by the District Court in the case at bar was compensatory in nature, not punitive. It is not exempt from discharge pursuant to §

523(a)(7), and is therefore a debt which is dischargeable and has been discharged in the Individual Defendants' bankruptcies.

C. The Courts below grossly misapplied the principles of restitutionary disgorgement in granting the relief ordered.

Pursuant to the general equitable grant of authority contained in the ILSFDA at 15 U.S.C. § 1719, the District Court ordered that the Individual Defendants disgorge $8.6 million in profits as restitution for the allegedly defrauded lot purchasers. The disgorgement remedy has its origins in securities fraud cases, Pidcock v. Sunnyland America, Inc., 854 F.2d 443, 446-47 (11th Cir. 1988), Litton Industries v. Lehman Bros., 734 F. Supp. 1071, 1074-76 (S.D.N.Y. 1990)(summarizing history and development of disgorgement remedy in securities cases), and is being applied in this case by analogy to the securities decisions. Kemp v. Peterson, 940 F.2d 110, 112 n. 1 (4th Cir. 1991).

1. The record contains no admissible evidence of damages.

When calculating damages in this action, the District Court proceeded upon the theory that CCMV bought lots for a low price, and then used sales practices allegedly prohibited by the ILSFDA to sell the lots at inflated prices. Kemp v. Cost Control Marketing and Management of Virginia, Inc., 790 F. Supp. 1275, 1278-79 (W.D. Va. 1992). It concluded that the amount it would order the defendants to disgorge would be the

difference between the fair market value of the lots and the amount for which the lots were subsequently sold. Id. This would equal CCMV's illegal profits. In order to fashion this remedy properly, HUD needed to furnish evidence of (1) the fair market value of all the lots, and (2) the amounts all of CCMV's customers paid for the lots. Rather than submitting admissible evidence of these facts, HUD instead filed the Henderson Declaration, a loose collection of hearsay gathered from survey responses to lot purchasers, which was then unthinkingly accepted by the District Court in its entirety over the Defendants' objections. (A98-A100)

Initially, the Henderson Declaration was not submitted by HUD for the purpose of finally calculating the amount of restitution. Rather, when the District Court was preparing to fashion its Interim Judgment Order, HUD requested that the Defendants be required to come up with an initial $100,000 contribution toward the lot purchasers' trust fund. Kemp 790 F. Supp. at 1278. HUD could only justify this amount if it could show that the Defendants' eventual liability, after all the evidence was in, would almost certainly exceed the requested initial payment of $100,000. Id. It then submitted the Henderson Declaration as evidence that the Defendants' eventual liability would most likely exceed $100,000. It was contemplated by all parties at this time that conclusive proof of damages would have to await further evidence.

In the Memorandum Opinion accompanying the Final Order of September 15, 1994, the District Court dispensed with the need to

take further evidence of damages by suddenly and without notice shifting the burden of proof to the Defendants. Cisneros v. CCMV, 862 F. Supp. 1531, 1534-35 (W.D. Va. 1994). It concluded that the approximation of damages contained in the Henderson Declaration would serve as the basis of the damages contained in the Final Order because the Defendants had failed to produce evidence to rebut it. Id. In doing so, the District Court improperly shifted the ultimate burden of proof on a material issue of fact to the Defendants. Furthermore, it did so without any notice to the Defendants, and in direct contravention of its Interim Judgment Order, which made explicit reference to HUD's burden to go forward with the evidence. Kemp v. Cost Control, 790 F. Supp at 1281-82.

As the sole authority for this burden-shifting tactic, HUD and the District and Fourth Circuit relied upon S.E.C. v. First City Financial Corp., 890 F.2d 1215 (D.C. Cir. 1989). If, as HUD asserts, First City stands for the proposition that the burden of proof with respect to all issues of damages may properly be shifted to the defendants in an administrative enforcement action, after the agency has proffered a modicum of hearsay on the issue, then it is poorly reasoned authority and should not be followed. As will be demonstrated, however, First City stands for no such thing.

At issue in First City was whether the defendants violated section 13(d) of the 1934 Securities and Exchange Act by failing to file a disclosure statement within the time required after acquiring over a five percent interest in the subject corporation. 890 F.2d at 1217. The District Court found that

the statute had been violated, and ordered the defendants to disgorge their illegal profits. Id. On appeal, the defendants challenged the District Court's measure of damages. Id. at 1230-31.

The S.E.C. and the District Court measured disgorgement as the total amount of the defendants' profit on the challenged transaction, which was the difference between the purchase price of the stock and the sale price of the stock. See, S.E.C. v. First City Financial Corp., 688 F. Supp. 705, 728 n. 24 (D.D.C. 1988). The defendants challenged this measure with the testimony of an expert, who purported to predict how much this total profit would have been diminished had the disclosure statement been timely filed. Id. at 727-28. Stated another way, the defendants contended that had they complied with the law, they still would have made money on the transaction, just not as much. Accordingly, the proper measure of damages, according to the defendants, is not the total profit on the illegal transaction, but only that amount of the profit which would not have been received but for the violation.

The appellate court recognized and accepted the proposition that any amounts ordered disgorged must be causally related to the fraud. 890 F.2d at 1231. However, it believed, as did the District Court, that the defendants' expert testimony, consisting of econometric predictions of stock market price responses to informational variables, was simply too speculative. Id. It was from this observation that sprung the statements relied upon by the Courts below in the case at bar. The First City court concluded that

since an actual measure of the precise amount of illegal profit is impossible, due to a plethora of uncertain variables, the measure of damages would have to be the total profit on the challenged transaction. Id. at 1232.

The distinction between First City and the instant case is a simple one. In First City, the defendants challenged not the quantum of evidence to support the court's findings, but the legal theory upon which the damage award was predicated. In the case at bar, the Defendants are challenging the District Court's interpretation of applicable law **and** the sufficiency of the evidence to uphold the damage award. The only evidence of damages in the record on this appeal is the multi-layered collection of inadmissible hearsay contained in the three-page Henderson Declaration. In First City, the District Court's summary of its factual finding took up twelve pages in the reporter volume, see, 688 F. Supp. at 708-19, and was drawn from transcripts of administrative hearings, pretrial depositions, and a trial transcript of over five hundred pages. Id. at 709 n. 2, 710 n. 3. In contrast to this appeal, the sufficiency of the evidence to support the District Court's factual findings was not at issue in First City.

Since it is impossible, as a practical matter (if not in theory), to distinguish between that portion of profit which is directly traceable to the violation, then the measure of damages can only be the total actual profit realized on the transactions. This is so because total actual profit can be precisely measured. The "illegal portion" of that profit cannot. Therefore, "the risk of uncertainty should fall on the wrongdoer

whose illegal conduct created that uncertainty." 890 F.2d at 1232.

In the words of Mark Batten, counsel for HUD below, the Henderson Declaration was only intended as an "initial guestimate" of damages to justify an initial interim disgorgement of $100,000. It should not have been admitted even for this limited purpose and was objected to by Defendants. The District Court compounded the gravity of this error, however, when it engaged in the unprecedented and impermissible shifting of the ultimate burden of proof of damages to the Defendants. As the burden of proof remained with HUD at all times, and it failed to introduce any admissible evidence on the issue, the District Court's calculation of damages, as affirmed by the Fourth Circuit, was error and must be reversed.

2. The record contains no evidence the Individual Defendants received any illegal profits.

The disgorgement remedy is only appropriate where the evidence indicates that those who are being ordered to disgorge illegal profits have in fact received illegal profits. The party seeking disgorgement has the burden of tracing the funds from the fraudulent transaction to the pocket of the party from whom disgorgement is sought. United States v. Bonanno Crime Family, 683 F. Supp. 1411, 1449 (E.D.N.Y. 1988). In order to support an award of disgorgement, the District Court must make detailed factual findings regarding the unlawful sources of the funds ordered disgorged. Schine Theatres

v. United States, 334 U.S. 110, 129 (1947). Otherwise, the relief would cease to be remedial, and would become an impermissible penalty. S.E.C. v. MacDonald, 699 F.2d 47, 54 (1st Cir. 1983), Zeller v. Bogue Electric Manufacturing Corp., 476 F.2d 795, 802 n. 10 (2d Cir. 1973), cert. denied, 414 U.S. 908 (1973), Restatement of Restitution § 150 (1937). If the relief ordered against each of the Individual Defendants is not limited by the amount of unlawful funds separately received by said Defendants, then it constitutes a penalty assessment and is unlawful. S.E.C. v. Texas Gulf Sulphur Co., 446 F.2d 1301, 1308 (2d Cir. 1971), cert. denied, 404 U.S. 1005 (1971), S.E.C. v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1104 (2d Cir. 1972).

The cases cited demonstrate the principle that restitutionary disgorgement of profits is not always an available remedy in every case of fraud. It is only appropriate where the evidence shows that the defrauding party was left in possession of profits derived from the fraudulent transaction.

The District Court below at first acknowledged the validity of this proposition, then in the next breath completely ignored it. See, Kemp v. Cost Control, 790 F. Supp. at 1279-80. The District Court first stated, "[t]he court therefore may only recover from the individual defendants restitution in an amount that can be shown to be equal to the benefit they received from CCMV as a result of the violations of the Act." Then, in the paragraphs that follow, the District Court indulges itself in speculation and fantasy regarding what the evidence "may show" and

what "probably" happened, and what the "history of the case suggests" could have happened. Id. at 1279. The only specific fact cited is that one of the Individual Defendants gave his son a gift of $300,000, ***prior*** to the start of the instant litigation. No evidence as to the origin of the gift exists in this record. The District Court concluded, "The fact that the defendants could conduct their financial affairs with so little restraint ***suggests*** that before the commencement of this action the individual defendants received sizable profits from the violations." (emphasis added).

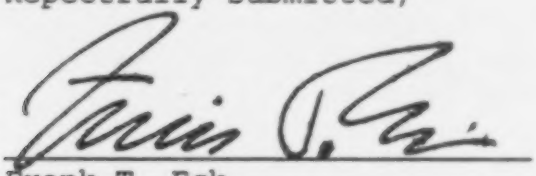
Even if one assumes that the Individual Defendants did "conduct their financial affairs with little restraint" prior to this litigation (and assume one must, for no evidence exists in this record), this merely establishes that before they were sued, the Individual Defendants lived comfortably. The assumption of wealth does nothing to establish the conclusion that the wealth was derived from any given source, be it inheritance, honest investments or unlawful activity. HUD utterly failed to satisfy its burden to prove that the Individual Defendants derived any profit from the allegedly illegal activities of CCMV, and the Courts below likewise failed to require the detailed factfinding necessitated by this Court's holding in Schine Theatres v. United States, 334 U.S. 110, 129 (1947).

X. CONCLUSION

Certiorari should be granted in this case to give further guidance to lower federal courts in the proper fashioning of

disgorgement remedies in the various contexts in which they arise, and to remedy the blatant disregard for this Court's precedent on the subject.

Repectfully submitted,



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